

Abstract

Abstract: Institutional quality and income level of countries can play different role in international trade, which can affect foreign direct investment and economic growth, both negatively and positively. Although the empirical evidence shows a mix result, few literatures specifically study the effect of FDI on economic growth and the role of institutions in FDI and economic growth in developing countries. This thesis is developed on the research of Roodman (2006, 2009) and Farole and Winkler (2012) but specifically focuses on the impacts of institutional quality on FDI-Growth nexus. This thesis is based on absorptive capacity theory and exogenous growth model to utilize dynamic panel GMM techniques robust to instrument proliferation. Finally, the thesis empirically tested the propositions through econometric models by regressing a static panel model and two-stage GMM equation. In summary, based on absorptive capacity theory, this dissertation not only contributes to literature by applying the theoretical model in FDI and economic growth in exploring interaction with the role of institutions and human capital on the FDI-growth nexus but also obtained some new empirical results in different income level groups to explore the impacts of macroeconomics situation that can affect our results. The results show that FDI can independently exert positive impact on economic growth and the positive effect only exists in high and upper-middle income countries. Institutional quality can have positive impact on FDI-induced growth but the results differ in different income groups. Human capital can act as a threshold in promoting FDI-growth nexus but the effects exist only in lower-income countries.

Keywords: FDI; Economic Growth; Institutional Quality; Absorptive Capacity; Dynamic panel model; GMM; Income level; Human Capital